



STATE OF INDIANA

Mitchell E. Daniels, Jr.
Governor

STATE BUDGET AGENCY
212 State House
Indianapolis, Indiana 46204-2796
317/232-5610

Adam M. Horst
Director

MEMORANDUM

DATE: December 5, 2011

TO: Governor Mitchell E. Daniels, Jr.

FROM: Adam M. Horst

SUBJECT: Update on state revenues and current fiscal condition

November revenue collections remained strong and ahead of the monthly target by \$10 million. In particular, sales tax continues to show solid results, with year-over-year growth of 8.6% for November (and 8.2% year-to-date). Through the first five months of FY 2012, state general fund revenues are now more than \$117 million ahead of target. I have attached the November revenue report as well as my commentary for your review.

While we will not have Global Insight's latest economic forecast until Friday and the official revenue forecast until next week (December 14th), **I am currently projecting that the revenue forecast will increase by at least \$117 million, the amount that we are ahead of target through November, and probably more.** My projections are based upon stronger than anticipated revenues during the last few months of FY 2011 and stronger than forecasted revenues during the first five months of FY 2012. These factors have increased the state's base revenue, meaning that even slower economic growth rates can produce sufficient revenue to meet or possibly exceed the April 2011 forecast. For instance, in the eight months since the April forecast was completed, actual collections have exceeded that forecast by \$257 million.

Late last week, we were notified by the Department of Revenue (DOR) about a programming error regarding a specific type of estimated payment (e-check only) for corporate income taxes. Each year, approximately \$12 billion of various taxes (e.g., sales, individual, corporate) flows through a "Collections" Fund before being swept by a software program into the appropriate state fund based upon the type of revenue. In 2007, the DOR provided corporations with the option of making estimated payments electronically using an e-check.

However, the report generated to summarize these transactions and provide the amount of funds to be swept identified all corporate income tax electronic payments except those made by e-check. This resulted in those funds continuing to accumulate in the "Collections" Fund without being properly transferred to the appropriate state funds. Specifically, these funds should have been swept to the state's general fund, but the software was not updated when e-checks were added as an option in 2007. **It is worth noting that 27 of 28 revenue streams were accurately identified and swept; corporate income tax submitted via e-check is the lone exception. And in recent years, the software program has swept over 99% of all funds deposited in the**

“Collections” Fund into their appropriate funds in a timely manner. Corporate income tax payments submitted via credit card were properly transferred, as were e-check and credit card payments for sales taxes, withholding taxes, estimated individual income taxes, and other excise taxes.

The end result is that corporate revenues have been understated since FY 2007. The exact figures by fiscal year are detailed in the table below:

| | E-Check Receipts | Percentage by Year |
|---------------|-------------------|--------------------|
| FY 2007 | \$ 4,730,578.05 | 1.5% |
| FY 2008 | \$ 29,574,930.01 | 9.2% |
| FY 2009 | \$ 56,243,768.64 | 17.6% |
| FY 2010 | \$ 58,300,950.61 | 18.2% |
| FY 2011 | \$ 139,194,582.51 | 43.5% |
| FY 2012 (YTD) | \$ 32,148,409.42 | 10.0% |

This problem was first identified in late November by an internal auditor within the DOR. You will recall that Commissioner Eckart created the internal audit function at DOR in 2007 as it previously did not exist. The error has been corrected effective December 1, 2011, and the DOR is working with the Auditor of State, State Budget Agency, and State Board of Accounts to make the appropriate adjusting entries for prior fiscal years and periods yet this week. I have also directed my staff to immediately notify all members of the Technical Forecast Committee of this information to properly incorporate it into the updated forecast.

Please note that the estimated payments have been properly credited to taxpayers’ accounts, so no taxpayers have been impacted by this issue. In addition, these funds have been invested by the Treasurer of State along with other funds, with the interest accruing to the state’s general fund.

Finally, this increase in state general fund revenue – both from the updated revenue forecast and the one-time transfer of the accumulated corporate e-check revenues to the general fund – will increase the state’s general fund reserves. **It is possible that the state will close FY 2012 with more than \$1.7 billion in combined balances based upon the latest available information. If this holds true, the Automatic Taxpayer Refund (ATR) included in the April budget would be triggered.** Any “excess” above 10% of FY 2013 general fund appropriations would be split evenly between an additional distribution to the Pension Stabilization Fund and an ATR. For instance, if the “excess” were determined to be \$300 million, then \$150 million would be transferred to the Pension Stabilization Fund and \$150 million would be distributed in the form of an ATR.
